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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 684

ESTATE OF HARRISON P. SHEDD, DECEASED, FIRST NATIONAL BANK OF ARIZONA, PHOENIX, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 125–138) are reported at 23 T. C. 41. The memorandum opinion of the Tax Court (R. 147–151) denying taxpayer's motion for reconsideration is not reported. The opinion of the Court of Appeals (Pet. App. 11–41) and the concurring opinion of Chief Judge Denman (Pet. 41–43) are reported at 237 F. 2d 345.

JURISDICTION

The judgment of the Court of Appeals was entered on October 9, 1956. Petitioner's motion for rehearing

was denied on November 13, 1956. The petition for a writ of certiorari was filed on January 9, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Under the will of the decedent, his widow received, for life, two-thirds of the income from a trust plus a general power of appointment over one-half of the corpus of the trust. There are remainders over in default of the exercise of the power. The question is whether the property over which the widow had the power of appointment qualifies for the marital deduction under Section 812 (e) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

The relevant provisions of Section 812 (e) (1) (A), (B) and (F) of the Internal Revenue Code of 1939, and of Section 81.47a of Treasury Regulations 105 are set forth in the Appendix, *infra*, pp. 8–12.

STATEMENT

The relevant facts, as stipulated by the parties (R. 23–117) and as found by the Tax Court (R. 126–129) and the Court of Appeals (Pet. App. 12–15), may be summarized as follows:

The decedent, Harrison P. Shedd, died a resident of Phoenix, Arizona, on November 1, 1949, and his estate is being administered under the laws of the State of Arizona. His estate consists of real and personal property which, during his lifetime, was his separate property. (R. 126–127.)

In his will, executed on January 19, 1946, the decedent, after leaving his personal effects to his wife and son, provided that the residue of his estate should be incorporated in a trust. Item VI of the will provides that the trustee shall distribute two-thirds of the income of the trust estate to decedent's wife and one-third of the income to his son during their respective lives, and it names certain beneficiaries who shall be entitled to the income upon their death. The trust was to terminate upon the death of the survivor of two named grandchildren, and the corpus was then to be distributed to the issue of these grandchildren with remainders over in default of issue. (R. 127.)

The decedent executed a first codicil to his will on May 9, 1946, making certain changes in the trust, but not changing the provision giving two-thirds of the income to his wife for life. (R. 127–128.) He executed a second codicil on July 26, 1948, adding the following paragraph to his will (R. 128):

> Notwithstanding any other provisions of this will, I hereby give and grant to my wife, Mary Redding Shedd, if she survives me, a power of appointment over one-half (½) of the corpus of the trust estate created under Item VI of this Last Will and Testament exercisable at any time during her life in her favor or in favor of others by written instructions filed with the Trustee or exercisable under her Last Will and Testament. In the event my said wife shall fail to exercise said power of appointment by her last unrevoked written instructions filed with the Trustee during her lifetime or under her Last Will and Testament, then the said one-half (½) of the corpus of the trust estate

> subject to her power of appointment shall be managed and distributed in accordance with the provisions of Item VI of my Last Will and Testament.

On October 16, 1950, prior to the distribution of the estate, decedent's wife filed written instructions with the executor-trustee exercising her power of appointment in favor of herself. Accordingly, pursuant to an order of the probate court, one-half of the residue of the estate was distributed to her. (R. 128.)

The Commissioner of Internal Revenue determined that the widow's interest in one-half of the residue did not qualify for the marital deduction and disallowed the claimed deduction in the amount of $218,617.51. The Tax Court sustained the Commissioner, holding that the interest of the surviving spouse did not qualify for the marital deduction since her interest was terminable within the purview of Section 812 (e) (1) (B) and did not come within the exception contained in Section 812 (e) (1) (F) of the Internal Revenue Code of 1939. (R. 128–138, 147–151.) The Court of Appeals affirmed. (Pet. 11–43.)

ARGUMENT

1. The question decided by the court below was whether the decedent's estate was entitled to a marital deduction under subparagraph (A) of Section 812 (e) (1) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 8). The surviving spouse was given a life interest in two-thirds of the trust income, plus a general power of appointment over one-half of the trust corpus, with remainders over in default of the exercise of her power to appoint. The decision be-

low, affirming that of the Tax Court, held that the estate was not entitled to the deduction because of the express provision of subparagraph (B) that a terminable interest is not deductible. Subparagraph (B) states in pertinent part that no deduction shall be allowed for the interest of the surviving spouse where "* * * upon the failure of an event or contingency to occur, such interest passing to the surviving spouse will terminate or fail" and the interest will then pass from the decedent to someone other than the surviving spouse or her estate. The court below held that the interest which passes to the surviving spouse must be measured as of the time of the decedent's death, and that, in the present case, since the interest passing from the decedent to her would terminate upon her death and would pass to someone other than her estate if she failed to exercise her power of appointment, her interest was clearly terminable within the purview of Section 812 (e) (1) (B).

The court below also held that the estate was not entitled to a deduction under Section 812 (e) (1) (F) (Appendix, *infra,* pp. 9–10). This subparagraph allows for the deduction of a terminable interest where (1) property is placed in a trust which provides that the surviving spouse is to receive *all* of the trust income and (2) the surviving spouse is given the power to appoint to herself or to her estate the *entire* trust corpus. As the court below held, it is evident that a life interest in two-thirds of the trust income and a power to appoint one-half of the trust corpus do not meet these terms.

The decision below is clearly correct and is consistent with decisions of other courts of appeals and of the Tax Court. *Estate of Hoffenberg* v. *Commissioner,* 22 T. C. 1185, affirmed *per curiam,* 223 F. 2d 470 (C. A. 2d); *Starrett* v. *Commissioner,* 223 F. 2d 163 (C. A. 1st); *In re Sweet's Estate,* 234 F. 2d 401 (C. A. 10th); *Estate of Melamid* v. *Commissioner,* 22 T. C. 966; *Estate of Reilly* v. *Commissioner,* 25 T. C. 366[1]; *Estate of White* v. *Commissioner,* 22 T. C. 641; *Estate of Kleinman* v. *Commissioner,* 25 T. C. 1245.

2. Petitioner contends (Pet. 6–10) that the court below failed to give due regard to local law in determining the nature of the interest which the surviving spouse received. It appears, however, that the court below fully considered (Pet. App. 25–35) the Arizona cases cited by petitioner (*In re Anderson,* 16 Ariz. 185, and *Estate of Hayward,* 57 Ariz. 51), and correctly concluded that those cases did not support the proposition that the property interests here involved passed to the surviving spouse as the "absolute owner."[2] In any event, it is clear that the question raised by the petition is limited to a construction of

[1] This was subsequently reversed by the Third Circuit on January 8, 1957, upon another ground, not here material.

[2] Having determined the nature of the widow's interest under local law, the court below correctly held that whether these interests qualified the estate for a deduction must be determined by the federal taxing statute (Section 812 (e) (1) (B) and (F), *supra*).

the terms of a particular instrument under local law and does not possess any general importance.[3]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY, 1957.

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[3] Additionally, Congress has dealt with the problem for the future by Section 2056 (b) (5) of the Internal Revenue Code of 1954 (26 U. S. C. 1952 ed., Supp. III, Sec. 2056), wherein it permitted a marital deduction for interests left in trust where the surviving spouse is entitled for life "to all the income from the entire interest, or all the income from a specific portion thereof" and has a general "power * * * to appoint the entire interest, or such specific portion * * *." Consequently, it would not appear that the determination of the court below, that the interest of the surviving spouse would not qualify for a deduction under subparagraph (F) of Section 812 (e) (1) (F) of the 1939 Code, would have any future importance.

APPENDIX

Internal Revenue Code of 1939:

SEC. 812. NET INCOME.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * * * *

(e) [As added by Sec. 361 (a) of the Revenue Act of 1948, c. 168, 62 Stat. 110] *Bequests, Etc., to Surviving Spouse.*—

(1) *Allowance of marital deduction.*—

(A) *In general.*—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

(B) *Life estate or other terminable interest.*—Where, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, such interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

(i) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(ii) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under clauses (i) and (ii))—

(iii) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For the purposes of this subparagraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

* * * * *

(F) *Trust with power of appointment in surviving spouse.*—In the case of an interest in property passing from the decedent in trust, if under the terms of the trust his surviving spouse is entitled for life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire corpus free of the trust (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the corpus to any person other than the surviving spouse—

(i) the interest so passing shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and

(ii) no part of the interest so passing shall, for the purposes of subparagraph (B) (i), be considered as passing to any person other than the surviving spouse.

This subparagraph shall be applicable only if, under the terms of the trust, such power in the surviving spouse to appoint the corpus, whether exercisable by will or during life, is

exercisable by such spouse alone and in all events.

* * * * *

(H) *Limitation on aggregate of deductions.*—The aggregate amount of the deductions allowed under this paragraph (computed without regard to this subparagraph) shall not exceed 50 per centum of the value of the adjusted gross estate, as defined in paragraph (2).

* * * * *

(26 U. S. C. 1952 ed., Sec. 812.)

Treasury Regulations 105, promulgated under Internal Revenue Code of 1939:

SEC. 81.47a [As added by T. D. 5699, 1949-1 Cum. Bull. 181, 195, 197, 198–200]. *Bequests, Etc., To Surviving Spouse.*—(a) *Allowance of marital deduction.*—In the case of the estate of a citizen or resident of the United States dying after December 31, 1947, there may be deducted the value of any property interest (except as otherwise provided in section 81.47b and 81.47d) which passed from the decedent to his surviving spouse. Such deduction is hereinafter referred to as the "marital deduction." * * *

* * * * *

(c) *Trust with power of appointment in surviving spouse.*—In the case of property interests which passed from the decedent to a trust, the terms of which satisfy the five conditions stated in this paragraph, the expression "passed from the decedent to his surviving spouse" embraces not only the beneficial interest therein of such spouse but also the interest therein subject to her power to appoint. (As to the treatment of trusts not meeting such conditions, see paragraph (b) (2) of this section.) The five conditions which must be satisfied by the terms of the trust are as follows:

(1) The surviving spouse must be entitled for life to all the income from the corpus of the trust.

(2) Such income must be payable annually or at more frequent intervals.

(3) The surviving spouse must have the power, exercisable in favor of herself or of her estate, to appoint the entire corpus free of the trust.

(4) Such power in the surviving spouse must be exercisable by such spouse alone and (whether exercisable by will or during life) must be exercisable in all events.

(5) The corpus of the trust must not be subject to a power in any other person to appoint any part thereof to any person other than the surviving spouse.

* * * * *

If the surviving spouse is entitled to only a portion of the trust income, or has power to appoint only a portion of the corpus, the trust fails to satisfy conditions (1) and (3), respectively. However, such conditions may be satisfied by one or more of several separate trusts created by the decedent. An undivided interest in property may constitute the corpus of a trust, and the will or a single trust instrument may create more than one trust.

* * * * *

In order to satisfy conditions (3) and (4), the power of the surviving spouse to appoint the entire corpus free of the trust must fall within one of the following categories:

(i) A power so to appoint fully exercisable in her own favor at any time following the decedent's death (as, for example, an unlimited power to invade).

(ii) A power so to appoint exercisable in favor of her estate. Such power, if exercisable during life, must be fully exercisable at any

time during life, or, if exercisable by will, must be fully exercisable irrespective of the time of her death.

(iii) A combination of the powers described under (i) and (ii). For example, the surviving spouse may until she attains the age of 50 years have a power to appoint to herself and thereafter have a power to appoint to her estate. However, condition (4) is not satisfied unless irrespective of when the surviving spouse may die the trust corpus will at the time of her death be subject to one or the other such power.

The power in the surviving spouse must be a power to appoint the corpus to herself as unqualified owner or to appoint the corpus as a part of her estate, that is, in effect, to dispose of it to whomsoever she pleases. Thus, if the surviving spouse entered into a binding agreement with the decedent to exercise the power only in favor of their issue, condition (3) is not met. The trust will not be regarded as failing to satisfy condition (3) merely because takers in default of the surviving spouse's exercise of the power are designated by the decedent. The decedent may provide that, in default of exercise of the power, the trust shall continue for an additional period.

In order for condition (4) to be satisfied, the power in the surviving spouse to appoint the corpus to herself or to her estate must be exercisable without the joinder or consent of any other person. The power is not "exercisable in all events," as required by section 812 (e) (1) (F), if it can be terminated during the life of the surviving spouse by any event other than her complete exercise or release thereof. For example, a power which is not exercisable in the event of the spouse's remarriage is not exercisable in all events.

* * * * *

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IN THE

Supreme Court of the United States

October Term, 1956.

No. 684.

ESTATE OF HARRISON P. SNIDER, Deceased, FIRST NATIONAL BANK OF ARIZONA, PHOENIX, Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petitioner's Reply to Brief in Opposition to Petition for Writ of Certiorari.

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IN THE

Supreme Court of the United States

October Term, 1956.

No. 684.

ESTATE OF HARRISON P. SHEDD, Deceased, FIRST NATIONAL BANK OF ARIZONA, Phoenix, Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petitioner's Reply to Brief in Opposition to Petition for Writ of Certiorari.

Respondent has mistaken the issues presented by the petition for certiorari. Lest his mistake be due to lack of clarity in the petition, we submit this reply to restate those issues.

1. We contend that the general law of property gave Mrs. Shedd a fee. Our petition's major point is that the Court below disregarded this general law in defining the extent of Mrs. Shedd's interest, thus enunciating a new and erroneous rule, conflicting with decisions from other Circuits and from this Court.

Respondent's only answer (Resp. Br. 6), that the Court below "fully considered" two Arizona cases we cited, misses the mark. Our point is that the Court *never did*

decide how local property law answers the question, "Did Mrs. Shedd take a fee?" The Court only decided (wrongly, we say) that two of the three Arizona cases cited to it were "not in point" (Pet. App. [redacted], 25, heading "4"; App. [redacted], 35, line 9). Very well; is there better Arizona law which *is* in point—and if so, what does the Court hold on the question of Mrs. Shedd's fee? The opinion says nothing. If there is *no* Arizona law in point, then the general common law of property governs; what does general law hold on the question of Mrs. Shedd's fee? The opinion says nothing, ignoring a 36-page discussion of general law in our briefs before that Court which discussed in detail the facts of over 50 cases demonstrating that Mrs. Shedd did take a fee.[1]

In its erroneous view of the law, the Court below considered itself justified in ignoring local or general law because it decided that local law is "not controlling" and "should here be disregarded." See 237 F. 2d 345 at 356, quoted Appendix B to Petition for Certiorari, pages 35-36. That is the real holding of the case.[2]

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[1]Actually, the Arizona cases to which the Court below and respondent devote such attention were only cited by us to show that Arizona law, if containing nothing directly in point, also contains nothing inconsistent with the proposition that Mrs. Shedd took a fee. The Court below and respondent's brief in opposition do not say otherwise.

[2]There is no other issue between the parties. Headings "2" and "3" of the opinion (237 F. 2d pp. 349-352, quoted Appendix B to Petition for Certiorari, pp. 17-20) petitioner never disputed at all. Points "5" and "6" (237 F. 2d 356-357, quoted Appendix B to Petition for Certiorari, pp. 36-37) petitioner does not urge here. Point "4" of the opinion (237 F. 2d 352-356, quoted pp. 25-35 of Appendix B) distinguishes at great length two Arizona cases—pure dictum in view of the Court's holding that local law makes no difference.

Rereading the part of the opinion just cited demonstrates that it is wrong, that it conflicts with other decisions of this Court (Pet. 9-11), of other Courts of Appeal (Pet. 6-9), of the Tax Court (Pet. 13, n. 4), and with the Commissioner's regulations (Pet. 12), to the confusion of the most important and most litigated area of today's federal estate tax structure.

2. Petitioner raises questions only concerned with its right to qualify under 1939 Code Section 812(e)(1)(A). We do not urge here the contention, made below, that petitioner has substantially complied with Subsection 812(e)(1)(F). See Petition, 3, line 1; Petition, 6, line 1.

Respondent is apparently unaware of this. *Every* Court of Appeals decision he cites to support his statement (Resp. Br. 6) that the decision below is "correct" and is "consistent with decisions of other courts of appeal" concerns Subsection (F) *only*. None of them deals with the questions raised here concerning the terminability of interests deductible under Subsection (A). See, *e. g., Starrett v. Commissioner*, 223 F. 2d 163, 164 (1st Cir. 1955), and compare with Court of Appeals cases quoted in Petition, 7-8, demonstrating that Shedd does conflict with decisions from other Circuits.[3]

Further evidence that respondent still thinks Subsection (F) is in issue here appears at the end of his brief. There

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[3]The Tax Court cases respondent cites (Resp. Br. 6) do not help resolve the questions raised by our petition for certiorari. They do involve questions of terminability of interests, but all deal with interests far more restricted than the "practical equivalent of ownership" which the Tax Court conceded the interest of Mrs. Shedd to be, and they all *heed* local law, not disregard it. See, *e. g., Melamid Estate*, 22 T. C. 966, 967-968.

he states that "the question raised by the petition * * * does not possess any general importance." He supports his conclusion with a footnote that Congress has "dealt with the problem" by amending former Subsection (F), so that the lower Court's determination under Subsection (F) "would [not] have any future importance."

We admit that the decision on the "(F)" issue is consistent with other appellate decisions, and that *that* problem has been resolved for the future by changes in the 1954 Code. (No change was made by the 1954 Code in former Subsection (A), the only section under which we could qualify upon this petition.) It is for those very reasons that we do not raise the "(F)" issue upon this petition for certiorari, and we wonder why the respondent says we do.

Conclusion.

For the reasons stated in this reply, we submit that the argument of the respondent in opposition to our petition for certiorari does not meet the issues raised by that petition. For the reasons stated in that petition, we submit that the petition should be granted.

Respectfully submitted,

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